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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1942

No. 42

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

WARREN TOOL CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

PETITION FOR CERTIORARI FILED MARCH 5, 1942
CERTIORARI GRANTED APRIL 6, 1942

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1942

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WARREN TOOL CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

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1 Before United States Board of Tax Appeals

Docket No. 96406

WARREN TOOL CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appearances: For Taxpayer: John C. Morley, Esq., Paul W. Frum, Esq., R. T. Sawyer, Jr. Esq. For Commissioner: T. F. Callahan, Esq., DeWitt M. Evans, Esq.

Docket Entries

1938

Dec. 12—Petition received and filed. Taxpayer notified. (Fee paid.)

Dec. 12—Copy of petition served on General Counsel.

1939

Feb. 1—Answer filed by General Counsel.

Feb. 1—Request for Circuit hearing in Cleveland, Ohio, filed by General Counsel.

Feb. 4—Notice issued placing proceeding on Cleveland, Ohio, Calendar. Answer and request served.

Feb. 20—Notice of the appearance of Paul W. Frum as counsel filed.

Aug. 31—Hearing set Oct. 23, 1939, in Cleveland, Ohio.

2 Oct. 25—Hearing had before Mr. Opper, Div. 14, on the merits. Submitted. (Consolidated for hearing and decision with Docket No. 99552). Stipulation of facts filed. Appearance of R. T. Sawyer, Jr., filed. Briefs due 12/9/39; Replies 12/26/39.

Nov. 4—Transcript of hearing 10/25/39 filed.

Dec. 9—Brief filed by taxpayer. 12/11/39 copy served on General Counsel.

Dec. 9—Brief filed by General Counsel.

Dec. 28—Reply brief filed by taxpayer.

1940

June 17—Memorandum findings of fact and opinion rendered, Clarence V. Opper, Div. 14. Decision will be entered under Rule 50.

July 11—Computation of deficiency filed by General Counsel. Agreed to.

July 16—Decision entered, Clarence V. Opper, Div. 14.

Oct. 4—Petition for review by United States Circuit Court of Appeals, Sixth Circuit, with assignments of error filed by General Counsel.

Oct. 11—Proof of service filed by General Counsel.

1940
Nov. 4—Motion for extension of time to Jan. 2, 1941 to complete and transmit the record filed by General Counsel.
Nov. 4—Order enlarging time to Jan. 2, 1941 to complete and transmit the record, entered.
Nov. 22—Statement of points filed by General Counsel. Proof of service thereon.
Nov. 22—Designation of portions of record filed by General Counsel. Proof of service thereon.

3 Before United States Board of Tax Appeals

Docket No. 99552

WARREN TOOL CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appearances: For Taxpayer: Paul W. Frum, Esq., R. T. Sawyer, Jr., Esq. For Commissioner: T. F. Callahan, Esq., DeWitt M. Evans, Esq.

Docket entries

1939
July 17—Petition received and filed. Taxpayer notified. (Fee paid.)
July 17—Copy of petition served on General Counsel.
Aug. 17—Answer filed by General Counsel.
Aug. 17—Request for circuit hearing in Cleveland, Ohio, filed by General Counsel.
Aug. 21—Notice issued placing proceeding on Cleveland, Ohio, Calendar, Answer and request served.
Oct. 4—Hearing set Oct. 23, 1939, Cleveland, Ohio.
Oct. 25—Hearing had before Mr. Opper, Div. 14, on the merits. Submitted. Consolidated for hearing and decision with Docket 96406. Stipulation of facts filed. Appearance of R. T. Sawyer, Jr., filed.
4 Nov. 4—Transcript of hearing 10/25/39 filed.
Dec. 9—Brief filed by taxpayer.
Dec. 9—Brief filed by General Counsel.
Dec. 11—Copy of brief served on General Counsel.
Dec. 28—Reply brief filed by taxpayer.

1940
June 17—Memorandum findings of fact and opinion rendered, Clarence V. Opper, Div. 14. Decision will be entered under Rule 50.
July 11—Computation of deficiency filed by General Counsel. Agreed to.

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July 16—Decision entered, Clarence V. Opper, Div. 14.
Oct. 4—Petition for review by United States Circuit Court of Appeals, Sixth Circuit, with assignments of error filed by General Counsel.
Oct. 11—Proof of service filed by General Counsel.
Nov. 4—Motion for extension to 1/2/41 to prepare and transmit record filed by General Counsel.
Nov. 4—Order enlarging time to Jan. 2, 1941, to prepare and transmit the record, entered.
Nov. 22—Statement of points filed by General Counsel. Proof of service thereon.
Nov. 22—Designation of portions of record filed by General Counsel. Proof of service thereon.

5 Before United States Board of Tax Appeals

Petition—No. 96406

Filed December 12, 1938

Warren Tool Corporation, the taxpayer and the above-named petitioner, hereby petitions for a redetermination of the deficiencies set forth by the Commissioner of Internal Revenue in his deficiency letter (IRA:90D) bearing date September 17, 1938, and as the basis of its proceeding alleges as follows:

1. The petitioner is a corporation organized and existing under the laws of the State of Ohio, with its principal office at Griswold Street Extension, Warren, Ohio.

2. The deficiency letter (copy of which is attached hereto and marked Exhibit A) was mailed to the petitioner on September 17, 1938, and states a deficiency in income tax for the taxable year ended December 31, 1936, in the sum of $3,037.25, together with interest thereon as provided by law, which is the tax and amount in controversy.

3. The determination of income tax and interest set forth in said deficiency letter is based upon the following errors:

(a) The Commissioner of Internal Revenue erred in disallowing the sum of $11,017.22 taken as a credit in determining undistributed net income in the computation of surtax on undistributed profits for the taxable year ended December 31, 1936, and the respondent erred in holding that said credit was not allowable in determining undistributed net income in the computation of surtax on undistributed profits for said year.

(b) The Commissioner of Internal Revenue erred in finding that undistributed net income for the purpose of computing surtax is $15,245.87 for the year 1936, and erred in failing to

find that the petitioner had no undistributed net income subject to surtax for said year.

(c) The Commissioner of Internal Revenue erred in finding that a deficiency in surtax of $1,883.38 with interest existed in consequence of failing to allow the credit mentioned in sub-paragraph (a) hereof, and in finding additional income as
6 mentioned in sub-paragraphs (d) and (e) hereof, and erred in failing to find that there was no deficiency in surtax for said year.

(d) The Commissioner of Internal Revenue erred in disallowing the sum of $974.83 on account of depreciation for the year 1936, and erred in failing to find that said deduction for depreciation was allowable in determining taxable net income for said year.

(e) The Commissioner of Internal Revenue erred in disallowing the sum of $6,025.30 for development expense for the year 1936, and erred in failing to find that the deduction for development expense was allowable in determining taxable net income for said year.

(f) The Commissioner of Internal Revenue erred in finding that the petitioner had taxable net income of $47,674.55 for the year 1936, and erred in failing to find that the petitioner had taxable net income of $39,979.27 for said year.

(g) The Commissioner of Internal Revenue erred in finding that a deficiency of income tax of $3,037.25 with interest existed for the year 1936 in consequence of failing to allow the credit mentioned in sub-paragraph (a) hereof, the allowance for depreciation mentioned in sub-paragraph (d) hereof, and development expense mentioned in sub-paragraph (e) hereof, and erred in failing to find that there was no deficiency in income tax for said year.

4. The facts upon which the petitioner relies as the basis for its proceeding herein are as follows:

(a) Pursuant to Article IV of the First Mortgage and Deed of Trust between Warren Tool Corporation and The Cleveland Trust Company, Trustee, dated November 1, 1932, the petitioner, out of its earnings for 1936, purchased $12,000. aggregate principal amount of its bonds at par plus accrued interest, turned them in to The Cleveland Trust Company, Trustee, pursuant to Article IV of the First Mortgage and Deed of Trust, and such bonds were cancelled by The Cleveland Trust Company, Trustee, prior to December 31, 1936. The taxpayer avers
7 that in consequence of this action it took a credit of $11,017.22 on its tax return for 1936, as a credit claimed under Section 26 (c) (2) of the Revenue Act of 1936, in com-

puting its undistributed net income for said year 1936; that it had no such undistributed net income whatever, and consequently none upon which a surtax could or should have been assessed.

(b) The petitioner charged on its books as an expense in the year 1936, the sum of $974.83, as depreciation on demolished drop hammer foundations and buildings, by reason of these facts:

The entire undepreciated portion of said demolished drop hammer foundations and buildings had been reported by the petitioner as an expense for the taxable year ended December 31, 1935, in its income tax return for 1935. The respondent disallowed these items as an expense for 1935, required them to be restored to the petitioner's books and the cost thereof recovered by depreciation. In November, 1936, the petitioner carried out these requirements of the respondent by appropriate entries on the books of the petitioner and by payment of a deficiency assessment for the year 1935. The amount of $974.83 is depreciation on said items for the year 1936.

(c) The petitioner charged on its books as an expense in the year 1936, the sum of $6,025.30, as experimental expense in connection with the development of a wrecking bar machine, which was completed during said year, and reported this amount as an expense in its income tax return for 1936. It was fully and finally determined by the petitioner in 1936 that the item of $6,025.30 was fully and finally expense by the petitioner in the year 1936, and should not properly be capitalized and recovered by depreciation.

Wherefore, the petitioner respectfully prays that the Board may hear and determine its appeal, and further prays that the Board may find that the petitioner owes no additional
8 income taxes for the year ended December 31, 1936, and that the Board may grant such other and further relief as the nature of the case may warrant.

JOHN C. MORLEY,
Counsel for the Petitioner,
1956 Union Commerce Building,
Cleveland, Ohio.

Of Counsel:

BAKER, HOSTETLER & PATTERSON,
1956 Union Commerce Building, Cleveland, Ohio.

[*Duly sworn to by Paul W. Frum; jurat omitted in printing.*]

9 *Exhibit A to petition*

CLEVELAND
IRA: 90D

TREASURY DEPARTMENT,
INTERNAL REVENUE SERVICE,
Cleveland, Ohio, September 17, 1938.

WARREN TOOL CORPORATION,
Griswold Street Extension, Warren Ohio.

GENTLEMEN: You are advised that the determination of your income tax liability for the taxable year(s) ended December 31, 1936 discloses a deficiency of $3,037.25, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, 415 Hanna Building, Cleveland, Ohio, Attention IRA: 90D. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates thirty days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,
Commissioner,
By R. C. CAKE,
Internal Revenue Agent in Charge.

Enclosures:
Statement.
Form of waiver.

10 STATEMENT

In re: Warren Tool Corporation, Griswold Street Extension, Warren, Ohio

TAX LIABILITY FOR TAXABLE YEAR ENDED DECEMBER 31, 1936

INCOME TAX

1936, Liability, $7,874.56. Assessed, $4,837.31. Deficiency, $3,037.25.

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated November 15, 1937; to your protest dated April 6, 1938; and to the statements made at the conference held on May 20, 1938.

In filing your return for 1936, a credit of $11,017.22 was claimed in determining undistributed net income in the computation of surtax on undistributed profits. The credit was claimed under Section 26 (c) (2) of the Revenue Act of 1936 and was based on a contract dated November 1, 1932, which you allege restricted the payment of dividends.

It appears that you were organized on October 11, 1932, and that on or about that date you acquired the properties of the bankrupt Warren Tool and Forge Company. An issue of $100,000.00 First Mortgage 10-year 6% Gold Bonds were authorized, of which $68,000.00 was issued. The bond indenture dated November 1, 1932 provided as follows:

"For the purpose of creating the sinking fund for the redemption of the bonds issued hereunder, the company hereby agrees to pay to the trustee on or before the first day of April 1935 and on or before the first day of April of each year thereafter, to and including April 1, 1942, a sum of money equal to 25% of its net earnings for the calendar year next preceding."

11 None of the outstanding bonds had been retired prior to the year 1936, and during that year the entire amount of $68,000.00 was purchased by you for cash. In order to finance the purchase, you borrowed $50,000.00 on December 1, 1936 from The Second National Bank of Warren, Ohio, and gave five notes for $10,000.00 each, payable annually on December 1, 1937 to 1941, inclusive. Bonds in the amount of $50,000.00 were posted as collateral on the notes and as the notes are paid off a like amount of bonds are to be returned to you and cancelled. Under your arrangements with the bank you are required to deposit in a special account $250.00 weekly, which amount is to be used to pay off the notes as they fall due.

It appears that the bond indenture was superseded by a new agreement dated December 1, 1936. It further appears that during the taxable year 1936 cash dividends of $26,437.50 were paid by you to your stockholders. The payments which were required under the bond indenture were not according to the provisions of said mortgage required to be made out of the earnings and profits of the taxable year. The same holds true with respect to the payments required under the provisions of the new agreement dated December 1, 1936. The credit of $11,017.22 as claimed under Section 26 (c) (2) of the Revenue Act of 1936 has therefore been disallowed.

ADJUSTMENTS TO NET INCOME

Taxable Year Ended December 31, 1936

Net income as disclosed by return		$39,979.27
Unallowable deductions:		
(a) Taxes decreased	$424.40	
(b) Depreciation decreased	974.83	
(c) Development expense	6,025.30	
(d) Reserve for discounts	270.75	7,695.28
Net income adjusted		$47,674.55

12 EXPLANATION OF ADJUSTMENTS

(a) The deduction claimed for taxes has been decreased $424.40. Ohio real estate taxes for the year 1936 claimed in the amount of $1,372.26 have been decreased to $1,013.86, the amount actually paid for that year. Federal capital stock tax of $805.00 as claimed has been increased to $814.00, the amount of tax for the year ended June 30, 1937, which accrued on July 1, 1936. Income tax of $75.00 paid on bond interest is not a proper deduction from gross income and therefore has been eliminated. These adjustments result in a decrease in the amount claimed for taxes of $424.40.

(b) Depreciation of $8,637.92 as claimed has been decreased to $7,663.09, resulting in an increase in net income of $974.83.

(c) The expense incurred in the development of a wrecking bar machine, which was charged to operations in the amount of $6,084.95, has been disallowed as a deduction as a patent covering this machine was issued to you on October 27, 1936. The amount disallowed represents the cost of the patent, and a deduction for amortization has been allowed for the taxable year 1936 of $59.65 based on seventeen years, the life of the patent. These adjustments result in an increase in net income of $6,025.30.

(d) The reserve for quantity discounts at December 31, 1935,

showed a balance of $9,926.94 and at December 31, 1936, a balance of $1,000.00. The decrease in the reserve of $8,926.94 was claimed as a deduction in filing your return in operating expenses. It appears that during the year 1936 $270.75 was transferred from the reserve and credited to surplus account. Therefore, the deduction claimed has been decreased by the latter amount.

Computation of Tax

Taxable Year Ended December 31, 1936

INCOME TAX

Normal Tax

	Taxable net income	$47,674.55
13	Less: Excess-profits tax	None
	Net income for normal tax computation	$47,674.55
8%	of $ 2,000.00	$160.00
11%	of $13,000.00	1,430.00
13%	of $25,000.00	3,250.00
15%	of $ 7,674.55	1,151.18
	Total normal tax	$5,991.18

SURTAX ON UNDISTRIBUTED PROFITS

Taxable net income		$47,674.55
Less:		
Excess-profits tax	None	
Normal tax	$5,991.18	5,991.18
(a) Adjusted net income		$41,683.37
Less:		
Dividends paid credit	$26,437.50	
Credit for contract restricting dividend payments	None	26,437.50
(b) Undistributed net income		$15,245.87
Less: Specific credit		831.66
(c) Remainder subject to surtax		$14,414.21
7% of $4,168.34		$291.78
12% of $4,168.33		500.20
17% of $6,077.54		1,033.18
Amount of Tax		$1,825.16
Plus: 7% of $831.66 (Specific credit)		58.22
Total surtax		$1,883.38
14 Normal tax		5,991.18
Total income tax (normal tax and surtax)		$7,874.56
Income tax assessed (normal tax and surtax):		
Original, account No. 400494		4,837.31
Deficiency of income tax		$3,037.25

Before United States Board of Tax Appeals

Petition—No. 99552

Filed July 17, 1939

Warren Tool Corporation, the taxpayer and the above-named petitioner, hereby petitions for a redetermination of the deficiencies set forth by the Commissioner of Internal Revenue in his deficiency letter (IRS:90D) bearing date June 27, 1939, and as the basis of its proceeding alleges as follows:

1. The petitioner is a corporation organized and existing under the laws of the State of Ohio, with its principal office at Griswold Street Extension, Warren, Ohio.

2. The deficiency letter (copy of which is attached hereto and marked Exhibit A) was mailed to the petitioner on June 27, 1939, and states a deficiency in income tax for the taxable year ended December 31, 1937, in the sum of $3,193.53, together with interest thereon as provided by law, of which $2,076.37, being additional surtax for such year, is the tax and amount in controversy.

3. The determination of income tax and interest set forth in said deficiency letter is based upon the following errors:

(a). The Commissioner of International Revenue erred in disallowing the sum of $13,053.52 taken as a credit in determining undistributed net income in the computation of surtax on undistributed profits for the taxable year ended December 31, 1937, and the respondent erred in holding that said credit was not allowable in determining undistributed net income in the computation of surtax on undistributed profits for said year.

(b) The Commissioner of Internal Revenue erred in finding that undistributed net income for the purpose of computing surtax is $20,640.35 for the year 1937, and erred in failing to find that the petitioner had undistributed net income subject to surtax for said year in the sum of $7,586.82.

(c) The Commissioner of Internal Revenue erred in finding that a deficiency in surtax of $2,725.65 with interest existed in consequence of failing to allow the credit mentioned in sub-paragraph (a) hereof, and erred in failing to find that the deficiency in surtax for said year was $649.35 with interest.

(d) The Commissioner of Internal Revenue erred in finding that a deficiency of income tax of $3,193.53 with interest existed for the year 1937 in consequence of failing to allow the credit mentioned in sub-paragraph (a) hereof, and erred in failing to find that there was a deficiency of income tax for said year of $1,117.16 with interest.

4. The facts upon which the petitioner relies as a basis for its proceeding herein are as follows:

(a) Pursuant to Article IV of the First Mortgage and Deed of Trust between Warren Tool Corporation and The Cleveland Trust Company, Trustee, dated November 1, 1932, the petitioner, out of its earnings for 1937, purchased $14,000. aggregate principal amount of its bonds at par plus accrued interest, turned them in to The Cleveland Trust Company, Trustee, pursuant to Article IV of the First Mortgage and Deed of Trust and such bonds were cancelled by The Cleveland Trust Company, Trustee, prior to December 31, 1937. The taxpayer avers that in consequence of this action it had and took as a credit $13,053.52 on its tax return for 1937, as a credit claimed under Sec-
16 tion 26 (c) (2) of the Revenue Act of 1937, in computing its undistributed net income for said year 1937; that it had undistributed net income for said year of $7,586.82 upon which a surtax of $649.35 with interest should have been assessed.

Wherefore, the petitioner respectfully prays that the Board may hear and determine its appeal, and further prays that the Board may find that the petitioner owes additional income taxes for the year ended December 31, 1937, only in the amount of $1,117.16 with interest, and that the Board may grant such other and further relief as the nature of the case may warrant.

PAUL W. FRUM,
Counsel for the Petitioner,
1956 Union Commerce Building,
Cleveland, Ohio.

Of Counsel:
BAKER, HOSTETLER & PATTERSON,
1956 Union Commerce Building, Cleveland, Ohio.

[*Duly sworn to by Thorn Pendleton; jurat omitted in printing.*]

17 *Exhibit A to petition*

TREASURY DEPARTMENT

INTERNAL REVENUE SERVICE

415 Hanna Building

CLEVELAND, OHIO, *June 27, 1939.*

CLEVELAND
IRA:90D

WARREN TOOL CORPORATION,
Griswold Street Extension, Warren, Ohio.

SIRS: You are advised that the determination of your income tax liability for the taxable year(s) ended December 31, 1937 discloses a deficiency of $3,193.53 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Cleveland, Ohio, for the attention of IRA:90D. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,
Commissioner.

By R. C. CAKE,
Internal Revenue Agent in Charge.

Enclosures:
Statement.
Form of waiver.

18 STATEMENT

CLEVELAND
IRA: 90D

In re: Warren Tool Corporation, Griswold Street Extension, Warren, Ohio

TAX LIABILITY FOR THE TAXABLE YEAR ENDED DECEMBER 31, 1937

Income Tax: Liability, $10,575.20. Assessed, $7,381.67. Deficiency, $3,193.53.

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated November 1, 1938; and to your protest dated February 13, 1939.

Your representative, Mr. Paul W. Frum, advised this office that a conference in the matter was not desired, therefore, the statutory notice of deficiency is being issued at this time.

In filing your return for 1936, a credit of $14,000.00 was claimed in determining undistributed net income in the computation of surtax on undistributed profits. The credit was claimed under Section 26 (c) (2) of the Revenue Act of 1936 and was based on a contract dated November 1, 1932, which you allege restricted the payment of dividends. It appears that you were organized on October 11, 1932 and that on or about that date you acquired the properties of the bankrupt Warren Tool and Forge Company. An issue of $100,000.00 First Mortgage Ten Year 6% Gold Bonds was authorized, of which $68,000.00 was issued. The bond indenture, dated November 1, 1932, provided as follows:

"For the purpose of creating the sinking fund, for the redemption of the bonds issued hereunder, the company hereby agrees to pay to the trustee on or before the first day of April, 1935, and on or before the first day of April of each year thereafter, to and including April 1, 1942, a sum of money equal
19 to 25% of its net earnings for the calendar year next preceding."

None of the outstanding bonds had been retired prior to the year 1936 and during that year the entire amount of $68,000.00 was purchased by you for cash. In order to finance the purchase, you borrowed $50,000.00 on December 1, 1936 from the Second National Bank of Warren, Ohio, and gave five notes for $10,-

000.00 each, payable annually on December 1, 1937 to 1941, inclusive. Bonds in the amount of $50,000.00 were posted as collateral on the notes and as the notes are paid off a like amount of bonds are to be returned to you and cancelled. Under your arrangements with the bank, you are required to deposit in a special account $250.00 weekly, which amount is to be used to pay off the notes as they fall due.

During the taxable year 1937, the sum of $14,000.00 was paid by you into the special account, which amount was claimed as a credit under Section 26 (c) (2) of the Revenue Act of 1936.

It appears that the bond indenture was superseded by a new agreement dated December 1, 1936. It further appears that during the taxable year 1936 dividends of $31,573.75 were paid by you to your stockholders. The payments which were required under the bond indenture were not according to the provisions of said mortgage required to be made out of the earnings and profits of the taxable year. The same holds true with respect to the payments required under the provisions of the new agreement dated December 1, 1936. The credit of $14,000.00, as claimed under Section 26 (c) (2) of the Revenue Act of 1936, has, therefore, been disallowed.

ADJUSTMENTS TO NET INCOME

Taxable Year Ended December 31, 1937

	Net income as disclosed by return		$55,611.59
20	Unallowable deductions:		
	(a) Reserve for Quantity Discounts	$4,186.18	
	(b) Capital stock tax	14.00	
	(c) Taxes decreased	251.88	4,452.06
	Net income adjusted		$60,063.65

EXPLANATION OF ADJUSTMENTS

(a) You claimed a deduction of $4,186.18 for quantity discounts representing the increase in the reserve account during the taxable year 1937. As the amount accrued and set up in reserve is not an actual and determined liability, it does not constitute a proper deduction for income tax purposes and, therefore, has been disallowed.

(b) Capital stock tax of $814.00, as claimed, has been decreased to $800.00, resulting in an increase in net income of $14.00.

(c) The deduction claimed for taxes on real estate and personal property was overstated by $251.88.

COMPUTATION OF TAX

Taxable Year Ended December 31, 1937

INCOME TAX

Normal Tax

Taxable net income	$80,063.65
Less: Excess-profits tax	None
Net income for normal tax computation	$80,063.65
8% of $2,000.00	$160.00
11% of $13,000.00	1,430.00
13% of $25,000.00	3,250.00
15% of $20,063.65	3,009.55
Total normal tax	$7,849.55

21 SURTAX ON UNDISTRIBUTED PROFITS

Taxable net income		$80,063.65
Less:		
Excess-profits tax	None	
Normal tax	$7,849.55	7,849.55
(a) Adjusted net income		$52,214.10
Less: Dividends paid credit		31,573.75
(b) Undistributed net income		$20,640.35
7% of $5,221.41		$365.50
12% of $5,221.41		626.57
17% of $10,197.58		1,733.58
Total Surtax		$2,725.65
Normal tax		7,849.55
Total income tax (normal tax and surtax)		$10,575.20
Income tax assessed (normal tax and surtax): Original, account No. 402853		7,381.67
Deficiency of income tax		$3,193.53

22 Before United States Board of Tax Appeals

Answer—No. 96406

Filed February 1, 1939

Comes now the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and in answer to the petition in the above-entitled proceeding, admits and denies as follows:

1 and 2. Admits the allegations contained in paragraphs 1 and 2 of the petition.

3 (a) to (g), inclusive. Denies that the Commissioner erred as alleged in subparagraphs (a) to (g), inclusive of paragraph 3 of the petition.

4 (a) to (c), inclusive. Denies the allegations of fact contained in subparagraphs (a) to (c), inclusive of paragraph 4 of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore specifically admitted, qualified or denied.

Wherefore, it is prayed that the appeal be denied.

(Signed) J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:
DEWITT M. EVANS,
Division Counsel,
THOS. F. CALLAHAN,
Special Attorney,
Bureau of Internal Revenue.

23 Before United States Board of Tax Appeals

Answer—No. 99552

Filed August 17, 1939

Comes now, the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue and for answer to the petition filed herein admits and denies as follows:

1. Admits the allegations contained in Paragraph 1 of the petition.

2. Admits that a deficiency letter was mailed to the petitioner on June 27, 1939, showing a deficiency in income tax for the taxable year ended December 31, 1937, in the sum of $3,193.53, together with interest thereon as provided by law, but denies the remaining allegations of Paragraph 2 of the petition.

3, (a) to (d), inclusive. Denies that the Commissioner erred in the manner and form, as alleged in subparagraphs (a) to (d), inclusive of Paragraph 3 of the petition.

4 (a). Denies the allegations contained in subparagraph (a) of Paragraph 4 of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore specifically admitted, qualified, or denied.

Wherefore, it is prayed that the appeal be denied.

(Signed) J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:
P. M. CLARK,
Acting Division Counsel.
THOS. F. CALLAHAN,
Special Attorney,
Bureau of Internal Revenue.

24 Before United States Board of Tax Appeals

WARREN TOOL CORPORATION, GRISWOLD STREET EXTENSION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

Docket Nos. 96406 and 99552

John C. Marley, Esq., Paul W. Frum, Esq., and R. T. Sawyer, Jr., Esq., for the petitioner.

DeWitt M. Evans, Esq., and Thomas F. Callahan, Esq., for the respondent.

Memorandum findings of fact and opinion

(Entered June 17, 1940)

OPPER: Respondent determined deficiencies in petitioner's income tax for the years 1936 and 1937 in the amounts of $3,037.25 and $3,193.53, respectively.

Petitioner assails respondent's action on the grounds that it was entitled to credit under section 26 (c) (2) of the Revenue Act of 1936, because of a contract requiring it to make payments to a sinking fund for the redemption of bonds issued by it, and was entitled to deductions for depreciation and development expenses for the year 1936.

FINDINGS OF FACT

All of the facts were stipulated and are so found. As far as pertinent for present purposes they are as follows:

Petitioner, an Ohio corporation, on November 1, 1932, executed a first mortgage and deed of trust to the Cleveland Trust Company (hereinafter called the trustee) securing bonds issued on that date in the amount of $300,000. Between November 1, 1932,

$5 C. C.C.

and January 1, 1935, an additional $18,000 of bonds were issued, and on January 1, 1935, $68,000 of bonds were outstanding. The bonds bore interest at the rate of 6 percent per annum.

The sinking fund provision in the mortgage was in part as follows:

25 "ARTICLE IV. Sinking Fund

"Section 1. For the purpose of creating the sinking fund for the redemption of the bonds issued hereunder, the Company hereby agrees to pay to the Trustee on or before the 1st day of April, 1935, and on or before the 1st day of April of each year thereafter to and including April 1, 1942, a sum of money equal to Twenty-five Per Cent (25%) of its net earnings for the calendar year next preceding. * * * The Company may, in lieu of depositing cash in whole or in part, purchase bonds issued hereunder at a price not exceeding the redemption price thereof as fixed by the provisions of Article V hereof, and deliver such bonds to the Trustee for credit against said sinking fund obligations to the extent of the purchase price (excluding the accrued interest) paid therefor by the Company. * * * Prior to the first day of April in each year abovementioned, the Company shall also file with such Trustee a statement sworn to by one of such officers showing the amount of the Company's net earnings for the preceding calendar year computed in the manner hereinbefore provided and duly certified by such accountant or accountants."

Petitioner for the calendar year 1934 had no net earnings as determined by its accountant in the manner provided in the above quoted section, and petitioner so advised the trustee by letter dated March 30, 1935.

Petitioner for the calendar year 1935 had net earnings, within the meaning of the above quoted section, in the amount of $15,020.84 and owed the trustee $3,755.21 for the sinking fund. It so advised the trustee by certified letter dated March 23, 1936.

Considering the sinking fund requirement, petitioner purchased on or about March 23, 1936, out of its net earnings for 1935, from the holders thereof, $5,500 of its first mortgage bonds and on that date delivered them to the trustee. The trustee cancelled,
26 discharged and cremated the bonds and applied them against the sinking fun requirements, which amounted to $3,755.21, as shown above.

On or about December 3, 1936, petitioner's accountant estimated that petitioner's net earnings, under the above quoted section of the mortgage, would be about $50,000. It delivered to the trustee $12,500 of its first mortgage bonds, for which it had paid

$12,755. These bonds had been purchased from their holders between November 9, 1936, and December 3, 1936, and were not a part of the $50,000 of bonds deposited with The Second National Bank of Warren as hereinafter described. These bonds were delivered in consideration of the sinking fund requirement and were cancelled and cremated by the trustee.

On February 10, 1937, petitioner certified to the trustee that its net earnings for the calendar year ending December 31, 1936, were $44,068.90, and therefore the payment owed to the trustee was $11,017.22, which had been satisfied as above related.

By letter dated November 9, 1936, petitioner offered to borrow from The Second National Bank of Warren, Warren, Ohio, the sum of $50,000 payable in five successive annual installments at $10,000 each, the first payment to be due on or before December 31, 1937.

The terms of this transaction, which were agreed to by the bank, appeared in the above described letter of November 9, 1936, and were in part as follows:

* * * * *

"1. Immediately upon the acceptance of this offer we will purchase all of our First Mortgage Ten Year Six Per Cent Gold Bonds which are now outstanding in the aggregate principal amount of $62,500.

"2. We will tender to The Cleveland Trust Company as Trustee, for cancellation and discharge, $12,500. of such bonds, leaving $50,000. of such bonds in our treasury.

"3. We will execute and deliver to you on or before
27 December 1, 1936, five (5) promissory notes dated December 1, 1936, payable to your order, each note in the principal amount of $10,000., as follows:

* * * * *

"4. We will secure said notes by depositing with you our bonds in the principal amount of $50,000., with 10,000. of such bonds to be released and redelivered by you to us for cancellation and discharge each time one of said notes is fully paid, and with interest coupons to be collected by us so long as such notes are not in default.

"5. We agree that if, without your consent, we issue any more of said bonds, or mortgage, sell, pledge or assign any of our property rights or franchises while any of the notes referred to herein are outstanding, or default in the payment of principal or interest on any of said notes, said notes shall forthwith become due and payable at your option.

"6. We are enclosing herewith a copy of a First Mortgage and Deed of Trust dated November 1, 1932, between Warren Tool

Corporation and The Cleveland Trust Company, Trustee, securing said bonds, and we agree upon request by you to enter into a supplemental agreement with The Cleveland Trust Company, Trustee, so that if we default in the payment of any of said notes it shall be considered an 'event of default' under Section 1, Article VI, of said First Mortgage and Deed of Trust."

* * * * * *

On the receipt of this loan of $50,000 on or about December 3, 1936, petitioner paid the trustee for the Pendleton Estates $48,000 for a like amount of its first mortgage bonds. Contemporaneously, this $48,000 of bonds were delivered at petitioner's order to The Second National Bank of Warren to be held by it under the terms above quoted and a trilateral agreement between petitioner, The Second National Bank, and the trustee, as shown
28 in a letter from petitioner to the trustee and The Second National Bank dated December 1, 1936, which stated as follows:

"In connection with the First Mortgage and Deed of Trust dated November 1, 1932 between Warren Tool Corporation and The Cleveland Trust Company, Trustee, (Mortgage) securing an issue of $100,000. First Mortgage Ten Year Six Per Cent Gold Bonds of Warren Tool Corporation (Bonds), and in consideration of a loan of $50,000. to be made to the undersigned, Warren Tool Corporation, by The Second National Bank of Warren, Ohio, we hereby represent, warrant, covenant and agree with you, jointly and severally, as follows:

"1. Under the Mortgage and aggregate principal amount of $68,000. of such Bonds have been authenticated, issued and delivered. $18,000. aggregate principal amount of such bonds have been surrendered to The Cleveland Trust Company for cancellation and discharge, and have been cancelled and discharged. $48,000. aggregate principal amount of said bonds are now held by us in treasury, and $2,000. aggregate principal amount of said bonds are held by S. K. Hine. The $48,000. of bonds held by us in treasury are to be delivered by us immediately to The Second National Bank of Warren as collateral security for the loan above referred to, and S. K. Hine has agreed to deliver the bonds held by him to The Second National Bank of Warren as collateral security for the loan above referred to on or about May 15, 1937, against payment thereof with interest accrued to the date of deposit, the amount of which principal and accrued interest has been deposited by us with The Second National Bank of Warren.

"2. Upon execution by Henry Pirtle as Trust Officer of The Cleveland Trust Company of an affidavit of good faith in
29 the form hereto attached, we will forthwith file a copy of

the Mortgage with such affidavit of good faith attached as a chattel mortgage, with the Recorder of Trumbull County, Ohio.

"3. We hereby authorize and instruct The Second National Bank of Warren, its successors and assigns, in the event we default in the payment of any of the notes evidencing said loan, or otherwise default in the performance of any of the terms and conditions of our loan agreement with The Second National Bank of Warren, to give written notice to The Cleveland Trust Company as Trustee to forthwith declare the principal of all of the Bonds then outstanding, if not already due, to be forthwith due and payable, in accordance with Section 2 of Article VI of the Mortgage, and we hereby authorize and instruct The Cleveland Trust Company as Trustee to act upon such notice from The Second National Bank of Warren, and without investigation of whether in fact a default has occurred in said notes or in said loan agreement, to declare the principal of said Bonds then outstanding, if not already due, to be forthwith due and payable, pursuant to Section 2, Article VI, of the Mortgage, and thereafter to take any and all actions and do any and all things authorized or permitted to be done under Article VI, 'Remedies upon Default', of said Mortgage."

Aside from the $50,000 received from The Second National Bank, petitioner did not have sufficient cash or quick assets to use for this purpose.

On or about December 3, 1936, petitioner deposited $2,060 with The Second National Bank of Warren for the purpose of paying S. K. Hine the principal amount of his bonds and interest to May 1, 1937, it being contemplated that Hine would return from Florida in May 1937 and be able to make delivery of his $2,000 in bonds. On or about May 7, 1937, Hine did surrender his $2,000 in bonds to The Second National Bank of Warren. The $50,000 of bonds were thereafter held by The Second National Bank of Warren as collateral security for the obligations evidenced by the five promissory notes dated December 1, 1936.

On or about December 2, 1937, petitioner's accountant estimated that its net earnings under the mortgage for the calendar year 1937 would be about $50,000. It delivered to the trustee $10,000 of its first mortgage bonds, for which it had paid $10,000. These bonds had been redelivered to petitioner by The Second National Bank of Warren on or about December 1, 1937, upon petitioner paying that bank the first $10,000 note which was due December 1, 1937. These bonds were cancelled and cremated by the trustee.

On or about December 28, 1937, petitioner, upon reconsideration of the matter, estimated that its net earnings for the calendar year 1937 would be about $52,000, based on the accountant's revised report. It delivered to the trustee $4,000 more of its first mortgage bonds on December 28, 1937, for which it had paid $4,000. These bonds had been redelivered to petitioner by The Second National Bank of Warren on or about December 28, 1937, upon petitioner paying that bank $4,000 on the second $10,000 which was due December 1, 1938. These bonds were cancelled and cremated by the trustee.

The net earnings of petitioner for the year 1937 were thereafter determined by its accountant to be $52,214.10, and therefore of the $14,000 of its first mortgage bonds deposited in December, 1937, $13,053.52 were one-fourth of the net earnings.

In December 1938, petitioner pursued the same method of operation as described above for the years 1936 and 1937.

During the taxable years in question petitioner made its income tax returns upon an accrual basis.

OPINION

Petitioner's claim for a credit under section 26 (c) (2), Revenue Act of 1936, based upon a contract requiring the pay-
31 ment of earnings and profits of the taxable year in discharge of a debt, has been disallowed by respondent. This action petitioner contests here. The principal ground relied upon by respondent as a justification for his position is that the contract did not require that the earnings and profits be paid or set aside within the taxable year. On this point petitioner must be sustained. The Strong Manufacturing Co., 41 B. T. A. — (May 29, 1940).

As to the taxable year 1937, respondent advances the further proposition that the contract pursuant to which petitioner made its payment was not entered into prior to May 1, 1936, as required by the statute. He bases this upon the fact that during that tax year the bonds with respect to which petitioner's payments were called for were being held only as collateral by the payee of a promissory note executed by petitioner subsequent to the critical date, the bonds having in the meantime been purchased by petitioner with funds supplied by the note creditor.

It seems clear that the bonds themselves were not extinguished by that transaction. *Virginia Securities Corporation* v. *Patrick Orchards, Inc., et al*, (C. C. A.—4), 20 Fed. (2d) 78, 84. The question remains whether petitioner's original undertaking to

contribute to the sinking fund established by the indenture under which the bonds were issued survived their transfer to the note holder as collateral. We think it did and that the obligation to maintain the sinking fund was effective so long as any bonds remained outstanding under the original indenture, even though held by a pledgee. *Bankers Trust Co.* v. *Denver Tramway Co.*, 233 N. Y. 604, 135 N. E. 936. That being so, the payments in question were called for by the original indenture which, having been entered into in 1932, was "executed by the corporation prior to May 1, 1936," as required by the applicable section. The credit should, therefore, have been allowed.

On the remaining issues no evidence has been presented, and the questions involved have been abandoned by petitioner, according to a statement in its brief. On these issues, respondent's determination is sustained.

Decision will be entered under Rule 50.

32 Before United States Board of Tax Appeals

Decision—No. 96406

(Entered July 16, 1940)

Pursuant to Memorandum Findings of Fact and Opinion of the Board entered on June 17, 1940, the respondent herein on July 11, 1940 having filed a recomputation of tax to which petitioner agrees, now, therefore, it is

Ordered and Decided: That there is a deficiency in income tax for the year 1936 in the amount of $1,449.88.

Enter:

[SEAL] (s) CLARENCE V. OPPER,
Member.

Before United States Board of Tax Appeals

Decision—No. 99552

(Entered July 16, 1940)

Pursuant to Memorandum Findings of Fact and Opinion of the Board entered on June 17, 1940, the respondent herein on July 11, 1940 having filed a recomputation of tax to which petitioner agrees, now, therefore, it is

Ordered and Decided: That there is a deficiency in income tax for the year 1937 in the amount of $1,117.23.

[SEAL] (s) CLARENCE V. OPPER,
Member.

33 In United States Circuit Court of Appeals

Petition for review and assignments of error—Nos. 96406 and 99552

Filed October 4, 1940

To the Honorable Judges of the United States Circuit Court of Appeals for the Sixth Circuit:

Now comes the Commissioner of Internal Revenue, by his attorneys, Samuel O. Clark, Jr., Assistant Attorney General, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and John M. Morawski, Special Attorney, Bureau of Internal Revenue, and respectfully shows:

I. Jurisdiction

The petitioner on review is the duly appointed qualified and acting Commissioner of Internal Revenue, hereinafter referred to as the Commissioner, holding his office by virtue of the laws of the United States.

The respondent on review, Warren Tool Corporation (hereinafter referred to as the taxpayer), is a corporation organized and existing under the laws of the State of Ohio, with its principal office at Griswold Street Extension, Warren, Ohio. The Warren Tool Corporation filed its income and excess-profits tax returns for the calendar years 1936 and 1937 with the Collector of Internal Revenue for the 18th District of Ohio, at Cleveland, Ohio, and within the judicial circuit of the United States Circuit Court of Appeals for the Sixth Circuit.

The petitioner files this petition pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

II. Prior proceedings

On September 17, 1938, the Commissioner determined a deficiency in income tax for the taxable year ended December 31, 1936, in the amount of $3,037.25, and on June 27, 1939, determined a deficiency in income tax for the taxable year ended December 31, 1937, in the amount of $3,193.53, and sent to the taxpayer by registered mail notices of said deficiencies in accordance
34 with the provisions of existing internal revenue laws. The taxpayer filed petitions for redetermination of said deficiencies by the United States Board of Tax Appeals, December 12, 1938 and July 17, 1939, respectively.

The cases were consolidated and were tried before the Board of Tax Appeals on October 25, 1939, at Cleveland, Ohio.

On June 17, 1940, the Board entered its memorandum findings of fact and opinion, and on July 16, 1940, entered its decisions that there are deficiencies in income tax for the years 1936 and 1937 in the respective amounts of $1,449.88 and $1,117.23.

III. Nature of controversy

The issue decided against the Commissioner relates to the credit claimed by the taxpayer, under Section 26 (c) (2) of the Revenue Act of 1936, in computing its liability for surtax on undistributed profits.

Taxpayer on November 1, 1932, executed a first mortgage and deed of trust to the Cleveland Trust Company (hereinafter referred to as the trustee), securing bonds issued on that date in the amount of $50,000.00. Between November 1, 1932, and January 1, 1935, an additional $18,000.00 of bonds were issued, and on January 1, 1935, $68,000.00 of bonds were outstanding. The sinking fund provision in the first mortgage and deed of trust appears in Article IV thereof. It provided that for the purpose of creating the sinking fund for the redemption of bonds issued under the first mortgage and deed of trust, the taxpayer agrees to pay to the trustee on or before the 1st day of April, 1935, and on or before the 1st day of April of each year thereafter to and including April 1, 1942, a sum of money equal to 25 per centum of its net earnings for the calendar year next preceding. The taxpayer may, in lieu of depositing cash in whole or in part, purchase the issued bonds and deliver them to the trustee for credit against the sinking fund obligations. Prior to the first day of
35 April in each year, the taxpayer shall file with the trustee a sworn statement as to its earnings for the preceding calendar year.

In connection with the sinking fund requirement, taxpayer on March 23, 1936, delivered to the trustee $5,500.00 of its first mortgage bonds which it had purchased. On December 3, 1936, taxpayer delivered to the trustee, in consideration of the sinking fund requirements, $12,500.00 of its first mortgage bonds. On February 10, 1937, taxpayer certified to the trustee that its net earnings for 1936 were $44,068.90, and that the payment owed to the trustee was $11,017.22 which had been satisfied by the delivery of $12,500.00 of bonds in December, 1936.

By letter dated November 9, 1936, the taxpayer offered to borrow from The Second National Bank of Warren, (hereinafter referred to as the bank), the sum of $50,000.00 under the

terms and conditions set forth therein. The terms, which were agreed to by the bank, provided that upon acceptance the taxpayer will purchase all of its outstanding first mortgage bonds in the aggregate principal amount of $62,000.00; that it will tender to the trustee, for cancellation and discharge, $12,500.00 of such bonds; that it will execute on or before December 1, 1936, five promissory notes dated December 1, 1936, each in the principal amount of $10,000.00; that it will secure said notes by depositing with the bank $50,000.00 of its first mortgage bonds, $10,000.00 of such bonds to be redelivered to taxpayer for cancellation and discharge each time one of said notes is fully paid; and that taxpayer agrees upon request by the bank to enter into a supplemental agreement with the trustee, so that in case of default in payment of said notes it shall be considered an "event of default" under section 1, Article VI of the first mortgage and deed of trust. By letter dated December 1, 1936, from the taxpayer to the trustee and to the bank, and approved by the trustee and the bank, it was provided that in the event of default in payment of any of the notes in question, the bank was authorized to notify the trustee to declare the principal of the outstanding bonds to be forthwith due and payable and the trustee was
36 authorized to declare the principal of said bonds forthwith due and payable and to take any and all actions authorized under Article VI, "Remedies Upon Default", of the first mortgage and deed of trust.

On the receipt of this loan of $50,000.00 on or about December 3, 1936, taxpayer purchased $48,000.00 of its first mortgage bonds and delivered them to the bank to be held under the terms of the $50,000.00 loan. On or about December 3, 1936, taxpayer deposited $2,060.00 with the bank in connection with the purchase of the remaining $2,000.00 of bonds outstanding.

In December, 1937, taxpayer delivered to the trustee $14,000.00 of its first mortgage bonds. These bonds had been redelivered to taxpayer by the bank, upon taxpayer paying the bank the first $10,000.00 note due December 1, 1937, and $4,000.00 on the second $10,000.00 note due December 1, 1938. The net earnings of taxpayer for 1937 were determined by its accountant to be $52,214.10.

The Commissioner, in his notices of deficiency, refused to allow any credit claimed for contracts restricting dividend payments. The taxpayer claims credits of $11,017.22 for 1936 and $13,053.52 for 1937. The Board sustained the taxpayer on the authority of *The Strong Manufacturing Company* (1940), 41 B. T. A. — No. 174 (now pending on Commissioner's petition for review by Circuit Court of Appeals for the Sixth Circuit).

IV. Assignments of Error

The Commissioner avers that in the record and proceedings before the United States Board of Tax Appeals and in the opinion and final decisions rendered and entered by the United States Board of Tax Appeals, manifest error occurred and intervened to the prejudice of the Commissioner who now assigns the following errors and each of them, which he avers occurred in said record, proceedings, opinion and final decisions so rendered and entered by the United States:

37 The Board erred:

1. In holding and deciding that there are deficiencies in income tax for the years 1936 and 1937 in the respective amounts of only $1,449.88 and $1,117.23.

2. In failing to sustain the deficiencies in income tax determined by the Commissioner for the years 1936 and 1937 in the respective amounts of $3,037.25 and $3,193.53.

3. In holding and deciding that taxpayer is entitled to the claimed credits of $11,017.22 and $13,053.52 for the years 1936 and 1937, respectively, under Section 26(c)(2) of the Revenue Act of 1936, in computing its liability for surtax on undistributed profits.

4. In holding and deciding that the question is controlled by The Strong Manufacturing Company (41 B. T. A. — No. 174) decision.

5. In failing to hold that no part of the earnings of the taxpayer for either of the taxable years 1936 and 1937 was required by any provision of the contract to be paid or irrevocably set aside within the taxable year for the discharge of a debt, and hence taxpayer is not entitled to any credit under Section 26 (c) (2).

6. In holding that the original undertaking to contribute to the sinking fund establishing by the indenture under which the bonds were issued survived their transfer to the note holder as collateral, and that the obligation to maintain the sinking fund was effective so long as any bonds remained outstanding under the original indenture, even though held by a pledgee.

7. In that its opinion and decisions are not supported by the evidence and are contrary to law.

Wherefore, the Commissioner petitions that the decisions of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Sixth Circuit, that a transcript of the record be prepared in accordance with law and with the rules of said Court and transmitted to the Clerk of said Court for

filing and that appropriate action be taken to the end that the errors complained of may be reviewed by said Court.

(Signed) SAMUEL O. CLARK, Jr.,
Assistant Attorney General,
(Signed) J. P. WENCHEL,
RLW
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:
JOHN M. MORAWSKI,
Special Attorney, Bureau of Internal Revenue.

[*Duly sworn to by John W. Morawski; jurat omitted in printing.*]

In United States Circuit Court of Appeals

Notice of filing petition for review

Filed October 11, 1940

To: WARREN TOOL CORPORATION,
Grinwold Street Extension,
Warren, Ohio.

You are hereby notified that the Commissioner of Internal Revenue did, on the 4th day of October, 1940, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Sixth Circuit, of the decisions of the Board heretofore rendered in the above-entitled cause. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 4th day of October, 1940.

(Signed) J. P. WENCHEL,
RLW
Chief Counsel,
Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 8th day of October, 1940.

WARREN TOOL CORPORATION,
By (Signed) N. ANDERSON, *President,*
Respondent on Review.

40 In United States Circuit Court of Appeals

Statement of points

Filed November 22, 1940

Comes now the petitioner on review herein and makes this concise Statement of Points on which he intends to rely on the review herein, to-wit:

The United States Board of Tax Appeals erred:

1. In holding and deciding that there are deficiencies in income tax for the years 1936 and 1937 in the respective amounts of only $1,449.88 and $1,117.23.

2. In failing to sustain the deficiencies in income tax determined by the Commissioner for the years 1936 and 1937 in the respective amounts of $3,037.25 and $3,193.53.

3. In holding and deciding that taxpayer is entitled to the claimed credits of $11,017.22 and $13,053.52 for the years 1936 and 1937, respectively, under Section 26 (c) (2) of the Revenue Act of 1936, in computing its liability for surtax on undistributed profits.

4. In holding and deciding that the question is controlled by The Strong Manufacturing Company (41 B. T. A. — No. 174) decision.

5. In failing to hold that no part of the earnings of the taxpayer for either of the taxable years 1936 and 1937 was required by any provisoin of the contract to be paid or irrevocably set aside within the taxable year for the discharge of a debt, and hence taxpayer is not entitled to any credit under Section 26 (c) (2).

6. In holding that the original undertaking to contribute to the sinking fund established by the indenture under which the bonds were issued survived their transfer to the note holder as collateral, and that the obligation to maintain the sinking fund was effective so long as any bonds remained outstanding under the original indenture, even though held by a pledgee.

7. In that its opinion and decision are not supported by its findings of fact and are contrary to law.

(Signed) J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

41 Service of a copy of the above statement of points is hereby acknowledged this 18th day of November, 1940.

(Signed) R. T. SAWYER, Jr.,
Counsel for Respondent on Review.

Before United States Board of Tax Appeals

Designation of portions of record, proceedings, and evidence to be contained in record on review

Filed November 22, 1940

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit, and deliver to the Clerk of the United States Circuit Court of Appeals for the Sixth Circuit, copies duly certified as correct of the following documents and records in the above-entitled cause, in connection with the petition for review by the said Circuit Court of Appeals for the Sixth Circuit, heretofore filed by the Commissioner of Internal Revenue:

1. Docket entries.
2. Pleadings:
   (a) Petitions
   (b) Answer to petitions.
3. Memorandum findings of fact and opinion, and decisions of the Board.
4. Petition for review.
5. Notice of filing petition for review.
6. Statement of points.
7. This designation.

(Signed) J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

42 Service of a copy of the within designation of portions of record, proceedings, and evidence to be contained in records on review is hereby admitted this 18th day of November, 1940.

(Signed) R. T. SAWYER, Jr.,
Counsel for Respondent on Review.

[Clerk's certificate to foregoing transcript omitted in printing.]

43 Before United States Court of Tax Appeals

Order enlarging time

On motion of counsel for the petitioner, it is

Ordered: That the time for preparation and transmission of the record in the above entitled proceeding in the United States Circuit Court of Appeals for the Sixth Circuit, be and it is hereby extended to January 2, 1941.

[SEAL] (Signed) C. R. ARUNDELL,
Member.

Dated: Washington, D. C., November 4, 1940.

Now, November 30, 1940, the foregoing is certified from the record as a true copy.

(Signed) B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

44 In United States Circuit Court of Appeals for the Sixth Circuit

Cause Argued and Submitted

(November 11, 1941)

Before HAMILTON, MARTIN, and MCALLISTER, JJ.

This cause is argued by Bernard Chertcoff for Petitioner and by Paul W. Frum for Respondent and is submitted to the court.

In United States Circuit Court of Appeals

Decree

(Entered December 9, 1941)

This cause was heard upon the transcript of the record, briefs and arguments of counsel, and on consideration whereof,

It is ordered, adjudged, and decreed that the order of the Board of Tax Appeals be and the same is affirmed in accordance with our opinion in Commissioner of Internal Revenue vs. Strong Manufacturing Company, — Fed. (2d) —, this day decided.

45 [Clerk's certificate to foregoing transcript omitted in printing.]

46 Supreme Court of the United States

Order allowing certiorari

Filed April 6, 1942

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Sixth Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

File No. 46346. U. S. Circuit Court of Appeals, Sixth Circuit, Term No. 42. Guy T. Helvering, Commissioner of Internal Revenue, petitioner, vs. Warren Tool Corporation. Petition for a writ of certiorari and exhibit thereto. Filed March 5, 1942. Term No. 42, O. T. 1942.

U. S. GOVERNMENT PRINTING OFFICE: 1942